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Federal Flood Insurance: The Repetitive Loss Problem

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Federal Flood Insurance: The Repetitive Loss Problem

Summary

Historically, flooding has been the most common natural disaster in the United States, costing more in property damages than any other natural disaster. In response to the trend of building homes and businesses in flood-prone areas and the increasing cost of damages caused by floods, Congress created the National Flood Insurance Program (NFIP) in 1968. The object was to reduce future flood losses through flood hazard identification, floodplain management (i.e., land use controls and building codes), and insurance protection. NFIP coverage is available to all owners and occupants of insurable property in a participating community.

Two flood insurance-related policy issues stand out in the 109th Congress. The first issue is the high and continuing cost of paying for repetitively flooded properties, and clarifying congressional intent with respect to restoring flood victims to pre-flood conditions. The problem with repetitive loss properties (RLPs) is that the vast majority of these older, generally less-safe properties were “grandfathered” into the NFIP when the program was created, and these properties have been repaired multiple times with subsidized flood insurance claim payments. Owners of RLPs pay less than the full actuarial risk rates. Congress started looking at the RLP problem (and other matters) several years before the National Flood Insurance Reform Act of 1994. The Flood Mitigation Assistance (FMA) Program was authorized as Section 1266 in 1994, and has largely been used to mitigate RLPs. The Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (P.L. 108-264), signed into law on June 30, 2004, doubled the authorization for that program but did not change its focus, despite some adjustment of priorities. The 2004 Act also added two new programs that are focused on RLPs — the Pilot Program and the Individual Property program. Although the statute authorized \$40 million a year for the Pilot program, subject to annual appropriations, the Administration’s budget request for FY2006 did not include funding. Legislation to appropriate the funds (H.R. 2360) is pending.

The second issue, which involves the adequacy of payments and the clarity of policies and procedures for filing and adjusting flood insurance claims after Hurricane Isabel in September 2003, was initially addressed by provisions in the 2004 act that made some programmatic changes to the NFIP and required several studies and reports.

This report traces the evolution of the NFIP and provides background information on the program. This is followed by a brief discussion of the problem of repetitively flooded properties and the mitigation program administered by FEMA. A summary of the major provisions in the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 is included. The report does not examine other important NFIP-related issues involving coastal erosion, the Coastal Barriers Resources System, market penetration, lender compliance, and NFIP financial conditions and managing systems.

This report will be updated to reflect significant legislative action.

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Federal Flood Insurance: The Repetitive Loss Problem

Introduction

Flooding in the United States is a recurring event, and the severity of flooding varies from year to year and from location to location. Historically, floods have caused more economic loss to the nation than any other natural hazard.¹ Almost 90% of all declared disasters include a flooding component.² Flood-related property losses have risen to \$6 billion a year, from approximately \$3.3 billion in the mid-1980s.³ Combating the devastating effects of flooding has become a national priority involving flood hazard identification, the purchase of federally-subsidized flood insurance by homeowners, renters, and business owners, and state and local land-use controls designed to minimize flood loss and guide development away from flood-prone areas. In 1968, through enactment of the National Flood Insurance Act,⁴ Congress established a comprehensive risk management program to: (1) reduce suffering and economic losses due to floods through the purchase of flood insurance; (2) promote state and local land-use controls to guide development away from flood-prone areas; and (3) reduce federal expenditures for disaster assistance and flood control.

This report provides an overview of the National Flood Insurance Program. Also examined are the problems surrounding the settlement of claims stemming from Hurricane Isabel in 2003 and recently enacted flood insurance reform legislation that addressed the repetitive loss issue.

Congressional Interest in Flood Insurance

Congressional interest in U.S. flood control policy (flood hazard mitigation and insurance) began in the late 19th century when extreme floods along the Mississippi River basin during the 1850s, 60s, and 70s caused calamitous socio-economic and human losses. This situation led Congress in 1879 to create the Mississippi River

¹ U.S. General Accounting Office, *Challenges Facing the National Flood Insurance Program*, GAO Report GAO-03-606T (Washington: April 1, 2003), p. 16.

² Jeff D. Opdyke, "Underwater, With No Insurance; U.S. Pushes Homeowners to Expand Flood Coverage in Wake of Recent Storms," *Wall Street Journal*, November 16, 2004, p. D2.

³ Alex Frangos, "U.S. Launching a Massive Effort to Redraw Nation's Flood Maps," *Wall Street Journal*, September 19, 2003, P. A1.

⁴ P.L. 90-448, 82 Stat 573.

Commission (1879-1928)⁵ to oversee the development of a levee system that would confine the river's natural flow. For almost 50 years, this seven-member advisory board pursued a strategy for regulating the Mississippi River. As the levee system neared completion in 1927, a massive flood overwhelmed the flood control project, damaging the reputation of the commission. While the levee system failed, the commitment to solve the flood problem solidified. The Flood Control Act of 1936⁶ launched a national program of structural flood control works. Together, the establishment of the commission in 1879 and the 1936 act highlighted a 60-plus year period when the federal government dealt with the threat of flooding in two basic ways: structural flood controls on rivers and shorelines (e.g., dams and levees), and post-disaster assistance for flood victims.

By the 1950s, however, it had become clear to Congress that these approaches left much to be desired. Public works were not always effective in the long run, while private construction continued in vulnerable areas. Legislative relief payments were problematic because they were unpredictable and necessitated bargaining after each major natural disaster. Pre-funding via insurance began to look like an attractive alternative to flood control or federal disaster assistance. Flood insurance coverage was virtually unavailable from the private insurance markets, however, because insurers could not profitably sell coverage at an affordable price due to the catastrophic nature of flooding and insurers' inability to develop actuarial rates that reflected the flood hazard risk.⁷

The earliest effort to formulate a viable federal flood insurance program dates back to 1951 when President Truman requested congressional appropriations for a national system of flood disaster insurance.⁸ Congress did not approve that request. Subsequently, however, in 1955 and 1956 the Senate Committee on Banking and Currency undertook an extensive study of the feasibility of creating a federal disaster insurance program.⁹ On the basis of that study, Congress passed the Federal Flood Insurance Act of 1956¹⁰ to establish a five-year, \$3 billion federal flood insurance and reinsurance program to be administered by the Housing and Home Finance Agency. The Federal Flood Indemnity Administration was created within the agency to perform the tasks authorized in the 1956 act. The 1956 act called for subsidized insurance rates and policies marketed by private insurance companies. This first flood insurance program, however, was short-lived. Not a single policy was written

⁵ Mississippi River Commission Act of 1879, 46th Cong., 1st sess., June 28, 1879, Chapter 43 (37-38).

⁶ 49 Stat. 1570.

⁷ During the late 1920s several dozen fire insurers sold flood insurance, but due to extreme riverine flood disasters during 1927 and 1928 in nearly all parts of the United States, all of these insurers withdrew from the market. From the late 1920s until today, flood insurance has not been considered profitable.

⁸ Howard Kunreuther and Douglas C. Dacy, *The Economics of Natural Disasters* (New York: The Free Press, 1969), p. 259.

⁹ U.S. Senate Committee on Banking and Currency, "Federal Disaster Insurance Report of the Senate Committee on Banking and Currency," *U.S. Senate Staff Study*, January 1956.

¹⁰ P.L. 84-1016; 70 Stat. 1078.

because — perhaps partially in response to a significant downturn in the economy — Congress did not appropriate any funds.¹¹ Consequently, the agency ceased to exist. Congressional concerns focused on the lack of a technical study to determine the costs of starting a federal program for flood insurance.¹²

A series of natural disasters in the early to mid-1960s triggered a renewed interest in Congress to create a comprehensive system of federal disaster insurance. That interest began to move forward when Congress enacted the Southeast Hurricane Disaster Relief Act of 1965.¹³ Primarily because of Hurricane Betsy and other hurricanes that devastated the South in 1963 and 1964, and heavy flooding on the upper Mississippi River in 1965, Section 5 of that act directed the Secretary of Housing and Urban Development (HUD) to undertake a nine-month study of the feasibility of alternative methods for providing assistance to those suffering property losses in floods, and other natural disasters.

A 1966 HUD feasibility study of a flood insurance program, entitled “Insurance and Other Programs for Financial Assistance to Flood Victims,” was submitted by President Lyndon Johnson to the Senate Committee on Banking and Currency.¹⁴ The study concluded that flood insurance was both feasible and could promote the public interest, although the rates in certain flood-prone areas could be extremely high.¹⁵ After an analysis of alternative ways of helping flood victims, the HUD study recommended providing a federal subsidy to existing occupants in high-risk flood areas. As a way to discourage further development in hazard-prone areas, the HUD study also suggested that the subsidy not be given to persons who proposed to construct new homes in areas subjected to flood hazard risks. In essence, once actuarial rates had been determined for a given area, no new flood insurance coverage could be provided unless the community adopted and enforced permanent land-use control ordinances, according to the study. In addition, the study asserted that subsidies to some existing occupants of flood-prone areas should be viewed as part

¹¹ Kunreuther and Dacy, 260.

¹² Ibid.

¹³ P.L. 89-339; 79 Stat. 1310.

¹⁴ U.S. Senate, Committee on Banking and Currency, *Insurance and Other Programs for Financial Assistance to Flood Victims: A Report from the Secretary of the Department of Housing and Urban Development to the President, as Required by the Southeast Hurricane Disaster Relief Act of 1965 (Public Law 89-339, 89th Congress, H.R. 11539, November 8, 1965)*, 89th Congress, 2nd Sess., Sep. 1966 (Washington: GPO, 1966).

¹⁵ On August 10, 1966, President Lyndon Johnson also submitted a presidential special task force report to the Speaker of the House of Representatives that examined ways the federal government could decrease flood losses without spending heavily on flood controls. Like the HUD study published that same month, the task force report concluded that a national program of flood insurance should be implemented and an integrated program be established to mitigate losses. The report warned, however, that an insurance program could aggravate rather than reduce development of the nation’s floodplains, and estimated that subsidies for existing high-risk properties would be required for approximately 25 years. See, *Communication from the President of the United States, Transmittal of A Report by the Task Force on Federal Flood Control Policy: A Unified National Program for Managing Flood Losses*, 89th Congress, 2d Session, House Document No. 465, August 10, 1966.

of an overall program of land-use management designed to reduce the exposure to flood hazard risks.¹⁶

The recommendations from the HUD feasibility study led Congress to pass the National Flood Insurance Act of 1968,¹⁷ which authorized the creation of the National Flood Insurance Program (NFIP). The NFIP incorporated most of the recommendations of the 1966 HUD feasibility study. It was expected that managing flood hazard risk through insurance would greatly reduce the reliance on federal disaster relief assistance. Property and business owners would in effect pre-fund their own flood-related property losses. Existing buildings in flood risk areas would receive subsidies on premiums because these structures were built before the flood risk were known and identified on flood insurance rate maps. Owners of structures built in flood-prone areas on or after the effective date of the initial Flood Insurance Rate Maps (FIRM) or after December 31, 1974, whichever was later, would have to pay full actuarial rates. The program also called for the development of flood hazard maps to identify flood risk areas and the requirement that local communities voluntarily adopt and enforce floodplain management ordinances that met or exceeded minimum NFIP standards.

Since its creation in 1968, the laws and regulations governing the NFIP's implementation have undergone many changes. Major revisions were enacted in 1973, 1977, 1994, and 2004. Today, the NFIP is the largest, single-line property insurer in the United States. Insurance claims payments, low-interest loans provided by the Small Business Administration (SBA), casualty loss deductions for uninsured losses on income tax, and Individual and Family Grants provided by the Federal Emergency Management Agency (FEMA) are the major elements of the federal government's efforts to deal with the financial effects of flooding.¹⁸ FEMA asserts that insurance claims payments minimize public expenditures for recovery while providing an efficient way to compensate victims of flood damage.¹⁹

The major flood insurance-related policy issues before the 109th Congress are:

- the cost of repetitive loss properties (RLP) and the effectiveness of FEMA's efforts at implementing its strategy for reducing losses associated with RLPs;
- making the program more fiscally sound; and

¹⁶ Ibid.

¹⁷ P.L. 90-448; 82 Stat. 573.

¹⁸ On March 1, 2003, President George W. Bush signed into law the Homeland Security Act of 2002 (P.L. 107-296) that transferred the Federal Emergency Management Agency (FEMA) to the Emergency Preparedness and Response Directorate (EP&R), a component of the U.S. Department of Homeland Security (DHS). Only the acronym FEMA was retained.

¹⁹ U.S. General Accounting Office, *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*, GAO Report GAO-04-401T (Washington: March 25, 2004), p.2.

- resolving allegations against FEMA and the NFIP stemming from the adjustment, processing and settlement of Hurricane Isabel claims.

The cost of paying RLP claims has placed a financial strain on the program. From a community standpoint, residents' lives are disrupted and may be threatened by repeated flooding. On the other hand, owners of RLPs view NFIP payments as a benefit they have purchased that enables them to remain in their homes. For over a decade, FEMA has actively pursued a variety of mitigation strategies to reduce flood-related losses. The NFIP had a program, known as "Section 1362", under which funds were made available to buy repetitively flood insured properties and transfer the land to communities. Critics, however, claimed it was cumbersome having the federal government buy the land. Congress eventually repealed the Section 1362 program and replaced it in 1994 with the Flood Mitigation Assistance (FMA) program that was originally authorized at \$20 million per year transferred from the National Flood Insurance Fund (NFIF). The funds are taken from the income associated with the flood policy service fees. Also, over the years FEMA has encouraged states and communities to use its other mitigation programs for RLPs, including the post-disaster Hazard Mitigation Grant Program (HMGP) and Pre-Disaster Mitigation (PDM) funds. On June 30, 2004, President Bush signed into law the Flood Insurance Reform Act of 2004²⁰ to reauthorize the NFIP through September 30, 2008, augment the FMA program, establish a five-year pilot program (through FY2009) for reducing severe RLPs, and make some programmatic changes to the NFIP intended to address administrative problems which came to light following Hurricane Isabel in September 2003.

Floods and Insurance Coverage

Of the two types of floods — riverine or inland stream flooding and coastal flooding — riverine floods typically cause the highest economic losses. On the other hand, coastal floods often cause greater loss of life. The Great Flood of 1993 that occurred along the Missouri and Upper Mississippi River basins is considered the most costly and devastating flood to ravage the United States. Its size and impact surpassed the 1927 flood disaster, noted earlier, in most categories: number of record river levels; the number of persons displaced, amount of crop and property damage; and, duration. A tragic combination of unique extreme weather and hydrologic conditions led to the flood of 1993.

Flooding is not confined to just a few geographic areas; almost every region of the country is subject to flooding. Some of the principal economic consequences of flooding are: (1) the cost of emergency services borne by state and local governments; (2) reductions in government revenue due to business interruption or business destruction (sales taxes) foregone and lower property tax revenues; (3) dollar value of flood-related deaths, bodily injury and mental anguish suffered by victims; and (4) post-disaster outlays by the federal government, such as loans and direct financial assistance to individuals for emergency housing, food, and clothing.

²⁰ P.L. 108-264; 118 Stat. 712.

Property damage caused by a general condition of flooding is explicitly excluded under most homeowner insurance policies sold in the private sector.²¹ Property insurance companies insist that flood insurance is not commercially feasible. As a general rule, property insurance markets will provide coverage (capacity) when insurers are confident that they can identify the risk and set insurance rates that cover expected losses. Insurers generally lack the ability to spread flood hazard risk sufficiently to safeguard their assets against catastrophic flood losses. Moreover, only people living in flood hazard areas would be expected to purchase flood insurance (so-called adverse selection) and these people would have frequent claims, making the coverage prohibitively expensive and, hence, not marketable. Private insurance companies have been unable or unwilling to pre-fund and diversify flood risks through insurance, reinsurance agreements or securitization.

National Flood Insurance Program

In 1968, Congress created the NFIP in response to the trend of development and redevelopment in flood-prone areas, the increasing damages caused by floods, and rising cost of taxpayer funded disaster relief for flood victims. Today, the NFIP is among the nation's largest domestic liabilities, along with the Social Security System and federal health programs such as medicare and medicaid. The NFIP involves a partnership among FEMA specialists and contractors, thousands of insurance agents and claims adjusters, private insurance companies, floodplain managers, and other public officials, lenders, and real estate agents. Federal flood insurance is currently offered to homeowner, renters, and business owners in over 20,000 participating communities that adopt and enforce floodplain management regulations which conform to NFIP standards.

Appendix A shows that by the end of the FY2004, almost five million (4,498,324) flood insurance policies were in effect for homeowners, renters, and business owners, representing \$723 billion of insurance in force.²² Federal flood insurance coverage is available on almost all types of buildings up to \$350,000 for residential types (\$250,000 for residential building coverage and \$100,000 for residential contents coverage), and \$1,000,000 for non-residential structures (\$500,000 building and \$500,000 contents.)

The NFIP serves two major functions: underwriting flood insurance and leading floodplain management. Various entities have specific roles to play under the NFIP. The federal government assumes all liability for the insurance coverage, sets the rates, coverage limitations, and eligibility requirements, designates special flood hazard areas (SFHA) with the issuance of flood insurance rate maps (FIRMs) and provides grant funding for mitigation planning activities. The private insurance sector sells insurance, adjusts and pays claims, and performs engineering and

²¹ It is because flooding is so predictable along many bodies of water that made private insurers avoid coverage.

²² For more information on flood insurance policy and claim statistics see data provided by FEMA, available at [<http://www.fema.gov/nfip/pcstat.shtml>], visited on April 20, 2005.

planning studies. The states coordinate the program and provide technical assistance to local participating communities. Finally local communities with jurisdiction over land use adopt, administer, and enforce floodplain development regulations.

The NFIP does not operate on the traditional insurance definition of fiscal solvency; rather, it operates under a statutory mandate that premiums on pre-FIRM structures — i.e., structures built before the issuance of a FIRM or before 1975, whichever is later — must be reasonable and, if necessary, be subsidized. The subsidy is provided by charging premium rates discounted from full actuarial rates. In order to make up the subsidized premium shortfall, NFIP has established a rating methodology consisting of a target level of premium income for the program as a whole that is at least sufficient to cover expenses and losses relative to what FEMA calls the “average historical loss year.” The premium level generated to cover the average historical loss year must accommodate the combined effect of the portion of NFIP business paying less than full risk premiums and the portion of the business paying full risk premiums. In the event that premium and investment income are inadequate in a given year, the NFIP can exercise its statutory authority to borrow up to \$1.5 billion from the U.S. Treasury to cover losses. Borrowed funds must be repaid with interest.

Identification and Mapping of Special Hazard Areas

The first step in assessing a community’s flood hazards is identifying and mapping the special flood hazard areas.²³ Flood maps provide the basis for establishing floodplain management ordinances (i.e., building standards), setting insurance rates, and identifying properties whose owners are required to purchase flood insurance.

FEMA issues FIRMs that delineate areas within the “100-year flood” boundary, called Special Flood Hazard Areas (SFHA), and flood insurance risk rate zones. The SFHA is based on NFIP’s “1%-annual chance flood” standard commonly called the “100 year flood.” A “100-year flood” is a calculation of the maximum stream discharge or coastal storm surge and resultant level of flood water that has a “one chance in 100” of occurring in any given year. The occurrence of a flood of this magnitude is independent of all other floods; indeed, a “100-year flood” may occur more than once in a given year, and even a number of times in a 10 or 20 year period. FEMA uses statistical methods or hydrologic calculations to determine the 100-year stream flow or coastal storm height based upon stream gauge records of river flows, storm tides, and rainfall. That information is related to topographic maps and field surveys using hydraulic analysis to then determine the predicted elevation of floodwaters.

Based on the expected flood elevation for a 100-year flood, the NFIP then delineates the area of inundation (i.e., SFHA) relative to elevation above sea level. These SFHAs receive a particular insurance risk zone designation.

²³ See 44 CFR § 65.1.

FIRMs also serve as guiding documents for communities as they regulate development in floodplains and for lenders that enforce mandatory flood insurance purchase requirements. Insurance companies and agents use the FIRMs as the source of risk information for underwriting and rating applications for flood insurance under the NFIP.

Accuracy of Flood Maps. An important policy issue for state and local officials, insurers, mortgage lenders, and property owners is that many flood maps have not been updated with detailed topography or more accurate methodologies or reflect real estate growth. Growth tends to increase runoff and alter drainage patterns on floodplains and, thus, increase flood hazard risk. An inaccurate flood map could result in flood damages to uninsured properties and larger than expected expenditures of federal disaster assistance.

Not all structures that lie within the same flood zone on a FIRM are subject to the same risk. The flood risk depends on factors such as how the home is built, elevation, and drainage. There are also instances where individual properties are inadvertently shown on a SFHA. The NFIP has made it possible through a flood zone correction process for homeowners to remove their homes from the SFHA, removing the mandatory flood insurance purchase requirement.

Flood Map Modernization. In May 1997, FEMA announced a flood map modernization initiative to update, revise and convert over 100,000 paper flood maps to new maps in digital electronic format that are more accurate, more accessible, and easier to keep current.²⁴ Some floodplain management experts agree that the updated flood hazard maps may have financial implications for homeowners and property developers in terms of insurance and construction costs. It is not certain, however, whether the map modernization process will increase or decrease the number of properties in the flood zones, or whether insurance premiums will rise or fall when the maps are updated.

In January 1999, FEMA requested that Congress authorize the agency to charge a transaction fee of \$15 for each federally insured mortgage to fund the NFIP's map modernization program. Congress did not approve the request. Instead, it authorized \$5 million to begin updating flood maps. Congress also instructed FEMA to evaluate alternative ways to fund the cost of modernizing flood maps. The options developed by FEMA included a map-user fee; an increase in the fee charged for each flood insurance policy; supplemental appropriations; and use of the NFIP's borrowing authority. In Fiscal Year 2003, Congress authorized \$150 million in general funds for map modernization and an additional \$200 million each in FY2004 and FY2005. For FY2006, the Bush Administration has requested an additional \$200 million.

Building on its flood map modernization efforts from the late 1990s, in August 2004 FEMA published its FY2004-FY2008 Multi-Year Flood Hazard Identification

²⁴ For more information on FEMA Map Modernization Program, see CRS Report RL32691, *FEMA's Flood Map Modernization Initiative*, by Wayne A. Morrissey.

Plan (MHIP). The Plan outlines five years of flood mapping activities.²⁵ The MHIP was envisioned by FEMA as a planning tool for identifying a long-term strategy for addressing the scope and sequence of the map modernization effort, but state floodplain managers say the MHIP has become something else. Rather, they see it as an implementation document dictating costs based on outdated estimates, rather than a planning tool. More important, they insist that the MHIP's implication that FEMA can map all communities in the nation with the current funding levels is erroneous. Instead, they argue that policymakers and stakeholders need to consider the total scope of the long-term effort to map the nation's floodplains, what priorities will be addressed in the initial effort, and the long-term plan to update the remaining flood maps, as well as a plan to maintain and update the maps in the future. The President's Map Modernization budget totals \$1.475 billion for the six-year period beginning in FY2003 and ending in FY2008.²⁶

Finally, FEMA has developed mapping partnerships with many states and some communities. While many partnerships are expected to be active during map modernization, some states and communities have expressed an interest in maintaining an ongoing role in maintaining the maps, including reviewing engineering reports that support map revisions and issuing letters of map change.

Community Participation

The NFIP has two phases in a community's participation in the program: the "emergency program" phase and the "regular program" phase. The emergency program was established in 1969 as the initial phase of a community's participation, during which insurable structures are eligible for limited amounts of cross-subsidized insurance before the effective date of the issuance of the community's FIRM.²⁷ Communities in the emergency program phase are not required to meet the NFIP's minimum floodplain requirements.

A community is eligible for the "regular program" when a FIRM has been completed and the community adopts the NFIP's minimum floodplain management standards in its local ordinances. FIRMs become the official zone designation that serves as the guiding document for communities developing land-use plans and for lenders in enforcing mandatory flood insurance purchase requirements. In the regular program, the NFIP authorizes the sale of additional flood insurance that is actuarially determined to reflect the probability of flood damages. Insurance on newly constructed buildings or substantially improved structures must be based on actuarial rates if construction work begins after the area is identified as having special flood hazards.

²⁵ For more information on FEMA's Multi-Year Flood Hazard Identification Plan, see *FEMA's Flood Hazard Mapping Web Site*, available at [http://www.fema.gov/fhm/mh_mhip.shtml], visited on April 12, 2005.

²⁶ Ibid.

²⁷ P.L. 91-152; 82 Stat. 397. Section 408 authorizes the "emergency implementation of a flood insurance program."

Policy Issuance and Claims Adjusting

Unlike the practice in private insurance markets, the NFIP accepts all insurance applicants and is not selective in evaluating individual applicants for flood insurance coverage. There is no individual risk analysis to determine the likelihood of a future loss, and individual property loss experience is not used as a rating criterion.²⁸ The sole criterion for accepting an applicant is that the insured property is located in a community that participates in the NFIP. The Standard Flood Insurance Policy (SFIP) is issued for all insured properties.

Federal flood insurance coverage is sold to eligible homeowners, renters, and business owners, either directly from the NFIP or through the “Write Your Own” (WYO) program. Under the WYO program, private insurers enter into a “Financial Assistant/Subsidy Arrangement” whereby they agree to issue flood policies in their own name and take responsibility for policy administration, claims processing, marketing and sales. Private insurers handle all claims issued in their name, and adjust and settle flood loss claims consistent with their general claims practices. In adjusting flood insurance claims, which are binding upon the federal government, a WYO insurer is authorized to use staff adjusters or independent contractors selected and supervised by the company. The WYO insurer also determines when and how adjusters will be compensated for their work on flood claims.

WYO insurers are compensated by the federal government for providing services, but assume no financial risk in settling claims. First, the WYO insurers collect the flood premiums and retain approximately 30% as an administrative fee to pay general administrative expenses associated with issuing the policy (e.g., agent commissions, marketing, operations). Second, they are reimbursed for loss adjustment expenses (i.e., direct and indirect expenses associated with settling claims). Third, WYO insurers are reimbursed by the NFIP for the services provided by claims adjusters according to a fee schedule. The balance of the premium that remains, if any, is sent to the NFIP. In the event retained premiums are not sufficient to pay claims and cover expenses, the WYO insurers may draw against Letters of Credit made available by FEMA with a bank.

WYO insurers are subject to certain standards and oversight as detailed in the NFIP’s “Write Your Own Program Financial Control Plan Requirements and Procedures” (FCPRP) manual. WYO companies must comply with monthly financial and statistical transaction reporting requirements. They are also subject to a review of operations — claims, underwriting, customer service, marketing, and litigation activities — every three years to assure that each company is meeting its

²⁸ Individual properties can be precluded from purchase of flood insurance under what is called “Section 1316”. It is a process by which communities and states can report to FEMA that an individual property is in violation of state/local floodplain management requirements and that efforts to get the property owner to bring the property into compliance have failed. FEMA then puts the property on a master list. If the property owner or a future property owner buys a policy, at some point it gets identified and the NFIP policy is rescinded. The idea is that a recalcitrant owner may refuse to comply with floodplain ordinances, but eventually the owner will find it hard to sell if flood insurance is not available.

performance objectives and adhering to program standards and policies. In addition, WYO insurers are subject to a “Biennial Claims Audit” every three years, and a “Claims Reinspection Program” that randomly reviews a percentage of WYO insurers’ claims settlement practices. State insurance regulators have some limited, indirect supervisory role over the financial aspects of the flood insurance operations of WYO insurers.

FEMA has outsourced most management and operation functions of the NFIP to Computer Sciences Corporation (CSC). CSC serves as the liaison between the federal government and WYO insurers. CSC provides FEMA with actuarial, financial and statistical analyses, and delivers flood-related training, consultation, support material and information clearinghouse services. Employees of CSC serve as claims managers for the WYO program and they handle requests for information and complaints by homeowners. Most of CSC’s operations associated with the NFIP are handled out of its Lanham, Maryland facility and involve systems engineers, software developers, flood insurance underwriters and claims adjusters, actuaries, accountants and other specialists. The company also processes flood insurance transactions for the NFIP from the Lanham facility.

Hurricane Isabel Flood Insurance Claims. On September 18 and 19, 2003, Hurricane Isabel struck several states along the East Coast, including Maryland, North Carolina, Virginia, West Virginia, New Jersey, Delaware and the District of Columbia. Historically high storm surges caused widespread flood damage to residential properties. Approximately 25,000 flood insurance claims related to Hurricane Isabel were filed during the weeks after the storm.

In the aftermath of Hurricane Isabel, concerns were expressed by policyholders, local and state officials, and Members of Congress about deficiencies in claims adjustment, processing, and settlement of flood insurance claims related to Hurricane Isabel. Some flood victims from Hurricane Isabel contended that receipts from flood insurance policies often failed to cover repair costs.

In response to complaints from flood victims and criticism from Members of Congress, the officials at the NFIP in April 2004 began offering independent reviews, if requested, of Hurricane Isabel claims. Claims were readjusted if review revealed that flood victims had not receive fair payments pursuant to the coverage. FEMA created a task force that undertook a review of 2,267 Hurricane Isabel claims and awarded \$8.6 million in 1,101 cases.²⁹ Critics, however, quickly charged that the NFIP claims review process was inadequate, and some flood victims had still not recovered the amount to which they are entitled.

According to FEMA, the reason that flood victims received claims settlements below the cost of repairing their homes was that the NFIP (and the 90th Congress) never intended to give victims full compensation for their flood-damaged homes or

²⁹ “Congress members Demand Probe of FEMA Claims,” *Washington Times*, Dec. 5, 2004, p. B5.

restore policyholders to “pre-flood conditions.”³⁰ Agency officials, under their reading of the NFIP, contend that the NFIP was designed only to *help* victims recover by imposing low-cost premiums, not to make them whole.

This position, however, differs from those held by previous presidential appointees responsible for the NFIP. J. Robert Hunter, former director of the Federal Insurance Administration (FIA) in the Ford and Carter Administrations, stated that the government “always restored victims to their pre-flood condition, less their deductible.”³¹ Similarly, Jo Ann Howard, who served as FIA director under President Clinton from 1998 until 2001, stated that her staff paid claims in a manner that restored damaged homes to their pre-flood condition. Further, according to Ms. Howard, the NFIP’s regulations provide no incentive for WYO companies to undercut a claim as they pass through the premiums and losses to the federal program, less their commissions for placing the coverage.³²

Resolving the policy issuance and adequacy of payment issues could require the courts to interpret the intent of Congress. In May 2004, several policyholders filed a class-action lawsuit in the U.S. District Court in Baltimore against eight WYO insurers.³³ The lawsuit alleges that these eight WYO³⁴ insurers used inaccurate and unrealistic pricing data to calculate repair and replacement costs on covered flood losses” and that this method of calculating claimants’ losses “systematically and uniformly undervalued the repair and replacement costs” which generated artificially low damage estimates and settlement offers.³⁵ In addition, the plaintiffs in the

³⁰ Testimony of David I. Maurstad, Acting Director and Federal Insurance Administrator, Mitigation Division, Federal Emergency Management Agency, Emergency Preparedness and Response Directorate, Department of Homeland Security before the House Financial Services Committee, Subcommittee on Housing and Community Opportunity, *Review and Oversight of the National Flood Insurance Program*, hearings, 109th Cong., 1st sess., April 14, 2005 (Washington: GPO, 2005), p.5.

³¹ Letter from J. Robert Hunter, Director of Insurance, Consumer Federation of America, to Steven J. Kanstoroom, Pattern Recognition and Fraud Detection Expert, November 18, 2004.

³² Letter from Jo Ann Howard, Jo Ann Howard & Associates, P.C. and former Federal Insurance Administrator, to Steve Kanstoroom, Pattern Recognition and Fraud Detection Expert, March 7, 2005.

³³ *Catherine Howell, et al v. State Farm Insurance Companies, et al*, Civil Action No. 1:04-CV-01494-BEL.

³⁴ These eight WYO insurers are State Farm Fire and Casualty Company, Omaha Property and Casualty, Standard Fire Insurance Company, USAA General Indemnity Company, Selective Insurance Company of The Southeast, Indemnity Insurance Company of North America, Harleysville Mutual Insurance Company, and Allstate Insurance Company

³⁵ Insurance adjusters typically use price data and construction estimating software that incorporate information and data published by The Craftsman Book Company. The Craftsman Book data, however, reflect the costs of new construction, not the cost of repair and renovation work following a natural disaster. The Company recommends that its labor and material cost estimates should be increased by 25% to 50% for work done following a major disaster. In addition, the company warns that their estimates are those of the
(continued...)

lawsuit argued that insurers failed to advise claimants that FEMA had extended the 60-day limit for filing an insurance claim to 120 days. Claimants were reportedly pressured to sign adjusters' proof of loss within 60 days of the flood even though they believed the adjusters had underestimated both the scope of damage and the associated costs of repair of their properties. Moreover, the WYO insurers are alleged to have compensated adjusters in a manner that created a conflict of interest between policyholders and adjusters, and this situation deprived policyholders of contract benefits. The lawsuit seeks injunctive relief requiring insurers to review and recalculate all claims using price data and construction estimates that reflect the actual cost of repairing and renovating flood-damaged housing, rather than the cost of new construction.

The 109th Congress faces seven issues that were revealed by Hurricane Isabel. These issues, which, on the whole, have led to artificially low damage estimates and settlement offers, include (1) controversy over FEMA's current interpretation of legislative intent with respect to the restoration of claimants to their pre-flood conditions; (2) lack of trained agents and adjusters; (3) training disparities between NFIP sales agents and adjusters; (4) compensating adjusters in a manner that creates a conflict of interest between policyholders and adjusters, thereby depriving policyholders of contract benefits; (5) lack of uniformity in claims estimates — e.g., adjusters taking depreciation on Replacement Cost Value (RCV) losses — and appeals; (6) calculating repair and replacement costs by using unrealistic construction pricing guidelines that do not reflect the actual costs of repair and renovation; (7) FEMA's failure to advise policyholders about the extended limit for filing an insurance claim and pressuring flood victims to accept the WYO company's claim estimate with an implicit threat of not receiving insurance benefits under the policy.

Meanwhile, Congress has taken some steps to address this issue with the enactment of the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (FIRA).³⁶ FIRA made some programmatic changes to NFIP to help address administrative problems related to Hurricane Isabel-related flood insurance claims. The new law, for example, requires the Director of FEMA to develop minimum educational requirements for insurance agents and brokers who write flood insurance policies, as well as to develop new forms, handbooks, and regulations governing the information given to policyholders regarding flood insurance and the processing of claims.

The 109th Congress might choose to clarify whether WYO insurers are subject to state insurance laws and the jurisdiction of state insurance regulators. Among the policy options potentially available to Congress are establishing standards for settling

³⁵ (...continued)

installing contractor, and do not reflect the contractor's overhead and profit, which increases the consumer's cost by another 25% to 50%.

³⁶ P.L. 108-264, 118 Stat. 712.

NFIP insurance claims compared to state law, or creating an institution to provide some independent oversight for compliance with those standards.³⁷

Flood Insurance Rates and Subsidies

The NFIP has two general classes of properties and a corresponding system of pricing: those insured at full actuarial rates and those insured at “subsidized” rates. Congress authorized subsidized rates on buildings constructed before the effective date of a community’s FIRM or before the application of the NFIP construction standards on December 31, 1974 (the so-called “pre-FIRM” structures). Owners of “pre-FIRM” structures pay rates that are less than full actuarial rates and are exempted from the NFIP’s floodplain management requirements unless they are substantially damaged or substantially improved, which triggers a requirement to rebuild to current construction and building code standards.

Premium Subsidy and Borrowing. Subsidies of premiums for pre-FIRM structures were envisioned to be important aspects of the NFIP’s start-up process. The subsidy was necessary because it was felt that (1) occupants did not understand the flood risk when they built in these areas (flood maps were not available); (2) occupants were not aware of flood hazard risk and there were no public safeguards prohibiting the occupancy of this land; (3) funds were already invested in the single largest family investment — the home; (4) subsidized premiums could have proved to be less costly to the federal government than disaster assistance; and (5) subsidies of pre-FIRM structures could provide an incentive to local communities to participate in the program and discourage unwise future floodplains construction.³⁸

By authorizing subsidized rates for pre-FIRM structures without providing annual appropriations to fund the subsidy, Congress did not set up the NFIP on an actuarially sound basis.³⁹ In 1981, FEMA shifted policy by increasing premium rates for pre-FIRM structures and establishing a goal of collecting sufficient revenue each year to at least meet the expected losses of an average historical loss year based on experience under the program since 1978. The goal, accomplished in 1988, has allowed for some accumulation of reserves during years when the NFIP experienced losses lower than average historical loss year. At present, the pre-FIRM subsidy is, on average, covered by the post-FIRM revenues.

³⁷ Steven B. Larsen, *Report to the County Executive of Baltimore County, Maryland on the Response to Flood Victims of Hurricane Isabel by Insurance Companies and Agencies of the State and Federal Government*, Baltimore, Maryland, Feb. 2, 2004.

³⁸ PriceWaterhouseCoopers, *Study of the Economic Effects of Charging Actuarially Based Premium Rates for Pre-FIRM Structures*, Washington, May 14, 1999, p. 1-2.

³⁹ U.S. General Accounting Office, *Flood Insurance: Information on Financial Aspects of the National Flood Insurance Program*, Statement of Stanley J. Czerwinski, Associate Director, Housing and Community Development Issues, Resources, Community, and Economic Development Division, GAO/T-RCED-00-23, October 27, 1999, p. 7.

NFIP's premium subsidies were intended to be phased out over time.⁴⁰ When the National Flood Insurance Act of 1968 was passed, it was expected that the number of pre-FIRM properties (and accompanying subsidies) would gradually diminish as they were damaged and rebuilt/relocated and subject to stronger floodplain management and building codes. According to FEMA, the subsidized rate for existing structures has dropped from 75% in 1978 to about 28% in 2004. Further, the premium paid by pre-FIRM structures is estimated to be less than 30% of the full actuarial rate.

Although the NFIP has been able to cover losses through the premiums charged to all policyholders, total income generated from insurance premiums and investments has at times been insufficient to pay claims in heavier loss years. The program has had to borrow from the U.S. Treasury to cover losses and other expenses in the short term. **Table 1** shows the history of Treasury borrowing and repayments under the NFIP from 1981 to 2005. When flood losses exceed the program's revenue, the NFIP is authorized to borrow up to \$1.5 billion from the U.S. Treasury, but must repay with interest what is borrowed.⁴¹ In 2004, the program had to borrow \$200 million from the U.S. Treasury, due primarily to an historic hurricane season.⁴²

Subsidized (Chargeable) Rates. Chargeable rates are set through the federal rule-making process, which includes provisions for advance publication of proposed rates and a period for comment by interested parties. In developing chargeable rates, FEMA first determines the revenue needed to meet an historical average loss year based on its current number of policies in-force and its expected loss and underwriting/administrative expenses. FEMA determines the revenue it will receive from policies with actuarially based rates. The expected revenue from actuarially based policies is then subtracted from the historical average loss year to determine the minimum premium income needed from policies with subsidized rates. The subsidized rate is then computed based on the minimum revenue needed and the number of subsidized policies. The proposed subsidized rate is published in the *Federal Register* for public comment and subsequently submitted for congressional approval as part of NFIP's budget and authorization proceedings.

⁴⁰ See "Study of the Economic Effects of Charging Actuarially Based Premium Rates for Pre-FIRM Structures," *PriceWaterhouse Coopers*, May 1999.

⁴¹ P.L. 104-208; 110 Stat. 3009. The Omnibus Consolidated Appropriations Act of 1997 included a provision to increase the NFIP's borrowing authority for FY1997 to \$1.5 billion from \$1 billion.

⁴² Testimony of Anthony S. Lowe, Federal Insurance Administrator, Director Mitigation Division, Federal Emergency Management Agency, Department of Homeland Security, before the Committee on Housing and Urban Affairs, Subcommittee on Economic Policy, 108th Congress, 2nd sess., March 25, 2004, p. 2.

**Table 1. History of Treasury Borrowing and Repayments
Under the National Flood Insurance Program**
(As of April 15, 2005)

Fiscal Year	Amount Borrowed	Amount Repaid	Cumulative Debt
Prior to FY1981 *	\$ 917,406,008	\$ 0	\$ 917,406,088
1981	164,614,526	624,970,099	457,050,435
1982	13,915,000	470,965,435	0
1983	50,000,000	0	50,000,000
1984	20,000,000	36,879,123	213,120,877
1985	0	213,120,877	0
1994 **	100,000,000	100,000,000	0
1995	265,000,000	0	265,000,000
1996	423,600,000	62,000,000	626,600,000
1997	530,000,000	239,600,000	917,000,000
1998	0	395,000,000	522,000,000
1999	400,000,000	381,000,000	541,000,000
2000	345,000,000	541,000,000	345,000,000
2001	600,000,000	345,000,000	600,000,000
2002	50,000,000	640,000,000	10,000,000
October 2002	0	10,000,000	0
February 2005	200,000,000	0	200,000,000
Total	\$4,259,535,534	\$4,059,535,534	\$200,000,000

Source: Federal Emergency Management Agency's Office of Legislative Affairs.

Notes: Borrowings through 1985 were repaid from congressional appropriations.

Borrowings since 1994 have been repaid from premium and other income.

* Balance forward from U.S. Department of Housing and Urban Development.

** Of the \$100 million borrowed, only \$11 million was needed to cover obligations.

Actuarial Rates. The NFIP method of establishing actuarial rates is based on the hydrologic method of estimating flooding damage risk outlined in the 1966 HUD report.⁴³ The hydrologic method was adopted for the NFIP as a way to overcome the difficulty of applying the traditional rate-making techniques to the risk of flooding. The problem was that actual flood loss history was not necessarily an accurate predictor of future flood damages. Engineering studies were needed to assess the probable risks of flooding for different locations — i.e., risk zones. The hydrologic method uses the techniques of analysis developed and used by hydrologists and hydraulic engineers to determine the economic feasibility of flood protection and flood-abatement projects. The approach is essentially a traditional benefit-cost analysis of the damages to property that would be prevented by the proposed flood-abatement project.

By combining information on the probability that floods of different severities will occur in a given year, and on the structural damage that will be suffered when a flood occurs, the NFIP is able to determine the actuarial rates for different types of property for different flood risk zones. Given that floods of different heights recur at different time intervals or frequencies in different geographic areas, hydrologists

⁴³ U.S. Senate, Committee on Banking and Currency, *Insurance and Other Programs for Financial Assistance to Flood Victims*, pp. 49-63

were able to derive probable damages for flood-prone areas which are divided into zones; each zone is defined by the frequency with which the zone will be flooded. Once the average percentage of the property's value that will be damaged due to a flood of a particular elevation is known, the NFIP is then able to determine an expected loss per \$100 property value covered by insurance. This per annum expected loss provides the "manual rates" for flood insurance premium.

In calculating the actuarial rates, the NFIP uses several factors: (1) the probability of the full range of possible floods and flood damages, including catastrophic levels; (2) hydrologic (water distribution) data; (3) mathematical and computer simulation of flood insurance claims; and (4) actual risk exposures that vary according to several risk-related features, such as the location of the property in relation to the flood hazard, the value of such property, and the average annual amount of damage that such property would suffer from flooding.⁴⁴ Based on this information, FEMA develops the pure premium portion of the actuarial rates (i.e., average annual damage) for different types of properties in different risk zones. FEMA continually reviews its NFIP loss history and adjusts NFIP rates to reflect risk.

From the owner's perspective, the factors used to determine the premium rate for flood insurance coverage are: the amount of coverage purchased; location, age of the building, occupancy, the design of the building, and the building's elevation.

Mandatory Flood Purchase Requirements

The purchase of federal flood insurance was voluntary from the inception of the NFIP in 1968 through 1973. During this period, communities faced no economic consequences for not participating in the NFIP, and property owners in flood-prone areas were not required to purchase coverage. Congress had assumed that communities in flood-prone areas would immediately avail themselves of federally subsidized flood insurance. By 1973, however, only 5,500 communities participated in the NFIP.⁴⁵ This low participation rate, and the fact that so few flood victims had flood insurance following major flooding in the early 1970s, led to the enactment of the Flood Disaster Protection Act of 1973⁴⁶. The 1973 Act revised the earlier law to make the purchase of flood insurance mandatory for certain property owners to remain eligible for loans from federally regulated lending institutions.

⁴⁴ U.S. General Accounting Office, *Flood Insurance: Information on Various Aspects of the National Flood Insurance Program*, Statement of Judy A. England-Joseph, Director, Housing and Community Development Issues, Resources, Community, and Economic Development Division, GAO/T-RCED-93-70, pp. 6-7.

⁴⁵ *Congressional Quarterly Weekly Report*, "Disaster Response: Does the Country Need a New National Strategy?" October 15, 1993, vol. 3. p. 895.

⁴⁶ P.L. 93-234; 87 Stat. 975.

Between 1973 and 1994, many policyholders continued to find it easy to drop policies, even if required by lenders. Federal agency lenders and regulators⁴⁷ did not appear to strongly enforce the mandatory flood insurance purchase requirements. The Midwest Flood of 1993 highlighted this problem and reinforced the idea that reforms were needed in order to compel lender compliance with the flood insurance purchase and retention requirements of the 1973 Act. In response, Congress passed the National Flood Insurance Reform Act of 1994 (NFIRA)⁴⁸ to make adjustments to the mandatory purchase requirements. Under the 1994 law, if the owner failed to get the coverage, lenders were required to purchase flood insurance on behalf of the property owners, and then bill the property owner. Lenders became subject to civil monetary penalties for not enforcing the mandatory purchase requirement.

In August 2000, the U.S. Senate Committee on Banking, Housing, and Urban Affairs released a GAO study of rate of compliance with federally regulated lending institutions on the NFIP's mandatory purchase requirement. That study was followed by a FEMA Inspector General report on compliance with the purchase requirement. Both reports concluded that the lenders were not meeting their obligation under the 1994 NFIRA to purchase flood insurance coverage.

Floodplain Management and Hazard Mitigation

In addition to mapping flood hazard areas and underwriting flood insurance, FEMA's other major role in the NFIP is to provide leadership in a nationwide effort to reduce future flood damages and protect the natural and beneficial functions of the floodplains. There is a division of responsibility in floodplain management. FEMA establishes the floodplain management requirements to be applied within the special flood hazard areas (SFHA) to prevent or reduce future flood damage. States and participating communities adopt these NFIP standards in their local ordinances. Compliance is achieved through the building permit process. State governments serve as an intermediary between participating communities and the federal government by providing technical assistance and training to local governments, floodplain managers, insurance agents and engineers. Participating communities regulate the location and design of floodplain construction in order to minimize flood loss and guide development away from flood-prone areas. The "100-year flood" is used as the standard for floodplain construction which requires elevation of the lowest floor of a structure above the level of the base flood as determined by the Flood Insurance Rate Study and shown on the FIRM.

Communities can be placed on probation for not adequately enforcing their ordinances or can be suspended from the program for failure to take corrective action. During probation a surcharge is added to insurance premiums in all policies in the community. Suspension from the program means insurance coverage is denied to property owners in the community.

⁴⁷ The federal entities for lending regulation are the Board of Governors of the Federal Reserve System, the Office of Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Farm Credit Administration.

⁴⁸ P.L. 103-325; 108 Stat. 2255.

Over the years, concerns have been expressed about the effects of subsidized flood insurance on the occupancy and use of the nation's floodplains.⁴⁹ The broad policy question in the occupancy and use of floodplains debate is whether flood probability assessment techniques, land-use planning methods, and damage-reducing land management policies have had the intended results. In other words, has the NFIP resulted in appropriate land use adjustments to slow (or reduce) the development of land that is exposed to flood damage, and thus minimize damages caused by floods nationwide?

Land-use planning techniques are used to influence and manage the type and density/intensity of uses and development on the land. The NFIP has implemented a number of tools and oversight systems to monitor, support and evaluate the quality of floodplain enforcement at the local community level. The NFIP, by statute, can only encourage states and local communities to adopt and enforce certain minimum floodplain management regulations. FEMA has consistently taken the position that federal land-use regulation should not be forced on local communities because this practice would be unworkable.⁵⁰

Repetitive Loss Problem

A major public policy issue before the 109th Congress is the cost to the NFIP of paying for repetitively flooded properties.⁵¹ According to FEMA, a relatively small number of RLPs account for a disproportionate share of paid flood claims.⁵² Insurance market analysts insist that by reducing the number of RLPs, actual flood insurance claims will be reduced, and this will both diminish the upward pressure to raise flood insurance rates and stabilize, in the long run, the financial condition of the NFIP.

Appendix B shows that a total of 112,540 properties nationwide have sustained repetitive losses, but only 50,644 of these properties had insurance, as of September 30, 2004. **Appendix C** shows that of these 50,644 RLPs, 11,706 are considered

⁴⁹ Joseph J. Cordes and Anthony M. J. Yezer, "In Harm's Way: Does Federal Spending on Beach Enhancement and Protection Induce Excessive Development in Coastal Areas?" *Land Economics*, vol 74, p. 128; Owen Ullman, "High Risk Life, High Expense to Taxpayers: Federal Disaster Aid Makes It Feasible to Build In Harm's Way," *USA Today*, July 24, 2000, p. 6A.; Owen Ullman, "Growth Reshapes Coasts: A Wave of Development Overwhelms the Shore," *USA Today*, July 21, 2002, p. 1A.

⁵⁰ David M. Bush, "Coastal Hazard Mapping and Risk Assessment," *Insurance Institute for Property Loss Reduction, National Committee on Property Insurance: Proceedings of the 1993 Annual Forum*, San Francisco, CA: Dec. 9, 1993, p. 19.

⁵¹ This problem first received public attention during the 106th Congress following the publication of the 1998 National Wildlife Federation report entitled, "Higher Ground: A Report on Voluntary Property Buyouts in the Nation's Floodplain."

⁵² U.S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, *Flood Insurance Reform Act of 2004*, report to accompany S. 2238, 108th Congress, 2nd sess., S. Report. 108-262 (Washington: GPO, 2004), p. 2.

severe repetitive loss properties (SRLP) that were placed in FEMA’s Target Group Special Facility. In total, there were 4,498,324 flood insurance policies — so RLPs are 1% of the total policies nationwide. Yet, according to FEMA, this 1% accounts for an annual average of 30% of amounts paid in claims.⁵³ Since 1978, RLPs have cost the NFIP about \$2.7 billion.⁵⁴ **Appendix D** shows that although RLPs exist in all 50 states, five states — Louisiana, Texas, Florida, North Carolina, and New Jersey — accounted for 63% of all repetitive loss payments from 1978 through 2004. The top 10 states accounted for 78% of all repetitive loss claims; and the top 25 states account for 96% of all repetitive loss claims.⁵⁵

The majority of existing flood-prone structures are residences (not vacation or income-producing homes) “grandfathered” into the NFIP when the program was created. These properties have been repaired multiple times with subsidized flood insurance claim dollars. FEMA estimates that 90% of RLPs were built prior to December 31, 1974, before the preparation of flood insurance rate maps (FIRM) and building codes that adequately reflected the probability of flooding in special flood hazard areas (SFHA). These older, generally less-safe pre-FIRM buildings were built before flood hazard risks were fully known and not constructed to resist flood waters. Moreover, most of the owners of RLPs pay subsidized rates for flood insurance. FEMA has sought over the years to prioritize RLPs and pursue a variety of insurance and mitigation strategies to stem the disproportionate costs to the NFIP associated with these properties.

As indicated above, conforming with congressional intent, flood insurance rates are subsidized.⁵⁶ The record indicates that Members understand that when the 90th Congress enacted the National Flood Insurance Act it was aware that pre-FIRM properties would experience a higher loss rate, and that flood insurance on these structures would be prohibitively expensive if the premiums were not subsidized.⁵⁷ It was thought that properly implemented building ordinances, the natural turnover of property, and rating and coverage changes would eventually produce cost savings to the NFIP from reduced flood damage. In addition, policy makers thought that providing subsidized insurance for existing buildings would lead to a dramatic

⁵³ S.Rept. 108-262, p. 2.

⁵⁴ U.S. General Accounting Office, *National Flood Insurance Program: Actions to Address Repetitive Loss Properties*, GAO Report GAO-04-401T (Washington: March 25, 2004), p.2.

⁵⁵ All data come from the National Flood Insurance Program.

⁵⁶ U.S. Congress, Senate, Committee on Banking and Currency, *Housing and Urban Development Act of 1968*, report to accompany S. 3497, 90th Cong., 2nd sess., S.Rept. 1123 (Washington: GPO, 1968). See also Conference Report No. 1785, July 23, 1968, to accompany S. 3497; and House Report (Banking and Currency Committee) No. 1585, July 25, 1968, to accompany H.R. 17989, which can be found at *U.S. Code Congressional and Administrative News*, 90th Cong., 2nd sess., 1968, vol. 2, pp. 1599-3202.

⁵⁷ U.S. Senate, Committee on Banking and Currency, *Insurance and Other Programs for Financial Assistance to Flood Victims: A Report from the Secretary of the Department of Housing and Urban Development to the President, as Required by the Southeast Hurricane Disaster Relief Act of 1965 (Public Law 89-339, 89th Congress, H.R. 11539, Nov. 8, 1965)*, 89th Congress, 2nd sess., September 1966.

increase in the number of property owners contributing to their own recovery through insurance, rather than relying on disaster assistance funded by taxpayers.

Factors Contributing to Repetitive Loss Properties

Most insurance market analysts agree that there are four factors contributing to the RLP problem. *First*, the NFIP has not effectively excluded pre-FIRM structures from receiving premium subsidies, as the program was initially envisioned by Congress, and thus RLPs have received a disproportionate share of NFIP payments for flood losses. Recall that the vast majority of RLPs are older pre-FIRM properties, which were initially constructed before the establishment of FIRMs and NFIP building standards.

Since the 1980s, FEMA has pursued a policy of encouraging states and local communities to remove damaged properties from the floodplain or elevate them above the 100-year flood level. Some critics of the effectiveness of this policy note that many buildings have been repaired at original elevations and continue to be classified as pre-FIRM properties eligible for subsidized insurance. These pre-FIRM properties contribute to a disproportionate share of flood losses under the NFIP.

Second, properties that sustained “substantial damage” are not subject to NFIP hazard mitigation requirements, and this has led to a disproportionate share of NFIP payments for flood losses. According to FEMA, a disproportionate share of NFIP claims are for RLPs that suffer less than 50% damages and, therefore, are not required to be rebuilt to appropriate floodplain management standards designed to reduce future losses. Communities must require that owners bring into compliance any building that is substantially damaged by any cause. Repetitive flood losses occur, in part, because this requirement is difficult to administer.

The cost of paying for RLPs is driven up because RLPs are damaged repeatedly but typically not beyond 50% of their value — the threshold that triggers the “substantial damage” standard requiring that structures be rebuilt to meet the program’s elevation standards.⁵⁸ Substantial damage means damage whereby the cost of restoration to the pre-damage condition would equal or exceed 50% of the market value of the structure before the damage occurred.

Many RLPs never reach the 50% threshold because a majority of the target buildings are in shallow flooding areas flooded only to the depth of a few feet; consequently, such flooding does not result in “substantial” damage. Thus, it is the number and cumulative amount of these losses that is the problem. Insurance market analysts have suggested that it might make better public policy to eliminate (e.g., buy-out, elevate, relocate) these potential future losses now rather than wait for these buildings to be substantially damaged. In September 1999, FEMA’s Inspector General published an audit which noted that many communities participating in the

⁵⁸ 44 CFR § 60.3(c)(2).

NFIP did not enforce substantial damage rules, with the result that subsidized rates were being provided to structures that should have been rated on an actuarial basis.⁵⁹

Officials in local participating communities typically encourage owners to use the Increased Cost of Compliance (ICC) coverage in NFIP policies to bring their buildings into compliance. ICC coverage, part of the Standard Flood Insurance Policy, pays towards the costs of bringing insured flood damaged homes and businesses into compliance with their community's floodplain ordinance. FEMA charges policyholders from \$3 to \$75 per year for ICC. The coverage limit is \$30,000.

Some floodplain management specialists insist that the ICC coverage has not been used as much as it should because it requires claims adjusters to know what they are doing; because adjusters are among the first professionals the owner sees after a flood, an adjuster is really in the optimal position to foster mitigation and use of ICC. Floodplain managers argue that FEMA and WYO insurers might need to do more to ensure that adjusters are properly identifying likely candidates and directing owners to the permit officials for required permits and evaluation of mitigation options — if buildings appear to be close to substantially damaged. Sometimes it is months before an owner gets around to seeking permits. (It should be noted that permit officials in small towns are quickly overwhelmed when they have many damaged buildings to be inspected.)

Third, a large share of RLPs are classified as being outside the designated 100-year floodplain, which raises concerns about the accuracy of flood insurance maps (see previous discussion on mapping) and the fact that the NFIP has not assessed the degree to which residents living in flood-prone areas purchase policies. The Government Accountability Office (GAO) has reported that FEMA's data on the total number of uninsured and insured structures in flood-prone areas are limited.⁶⁰ While FEMA tracks data on the number of insurance policies in these areas, data on the overall number of structures are incomplete. In response to congressional concerns stemming from the GAO study, FEMA announced has taken steps to improve the quality of its data on the number of structures in flood-prone areas and is participating in the development of new mapping technologies that could facilitate the collection of such data.

Fourth, the accuracy of flood maps which capture actual risks facing properties in flood zones is a contributing factor for repetitive losses. According to FEMA, the number of homes (both insured under the NFIP and uninsured) damaged or destroyed from flooding after some recent hurricanes (e.g., Hurricane Isabel in 2003) was higher than most experts had predicted. Some observers note that the unexpected

⁵⁹ Federal Emergency Management Agency, Office of Inspector General, *Audit of the Effectiveness of the Substantial Damage Rule*, H-03-99, Sept. 1999.

⁶⁰ U.S. General Accounting Office, *Flood Insurance: Emerging Opportunity to Better Measure Certain Results of the National Flood Insurance Program*, GAO Testimony GAO-01-736T (Washington: May 12, 2001), p. 23.

losses were due to inaccurate flood maps, including instances of buildings simply not being shown in flood zone areas of the FIRM.⁶¹

Repetitive Loss Property Mitigation Strategy

There have been efforts over the years by FEMA to reduce both the number and vulnerability of repetitively flooded properties.⁶² FEMA's Repetitive Loss Strategy is a cost containment initiative designed to benefit all NFIP policyholders. The following is a brief summary of FEMA's past and current efforts to address the problems associated with existing flood-prone structures.

Past Efforts. In July 1998, the National Wildlife Federation published a report entitled, "Higher Ground: A Report on Voluntary Property Buyouts in the Nation's Floodplains," that analyzed the NFIP's claims data on repetitively flooded properties and discussed voluntary buyout and relocation programs in the context of restoring the natural flood protection capacity of floodplains. The report outlined a compelling argument for non-structural measures and the restoration of the nation's floodplains. In response to criticism of the NFIP found in the report, FEMA announced a series of proposals designed to reduce disaster losses, including attempts to reduce the subsidy provided to repetitive loss properties (particularly vacation homes, rental properties, and other non-primary residences) that experience repetitive losses, as well as attempts to terminate flood insurance coverage for the worst offending repetitive loss properties.⁶³

In December 1993, Congress passed the Hazard Mitigation and Relocation Assistance Act of 1993 that included a provision to increase the formula for post-disaster HMGP support for mitigation to 75% from 50%.⁶⁴ The law clarified what constituted acceptable conditions for the purchase of damaged homes and businesses. In addition, the law clarified that purchased land be dedicated in perpetuity for open space uses.

The National Flood Insurance Reform Act of 1994⁶⁵ made comprehensive changes to the NFIP, including establishment of the Flood Mitigation Assistance program to provide grants to states and communities based on a 75%-25% cost share

⁶¹ Federal Emergency Management Agency, Office of Inspector General, *Audit Division, Audit of FEMA's Cost Estimate for Implementing the Flood Map Modernization Plan*, H-09-00, Sep. 2000, p. 44.

⁶² U.S. Federal Emergency Management Agency, *Memorandum to National Flood Insurance Program Stakeholders from Jo Ann Howard, Administrator of Federal Insurance Administration, on FEMA's Repetitive Loss Property Strategy*, (Washington: May 2000), p. 2.

⁶³ U.S. General Accounting Office, *Flood Insurance: Information on the Financial Condition of the National Flood Insurance Program*, GAO Report GAO-01-9992T (Washington: July 19, 2001), p. 13.

⁶⁴ P.L. 103-181; 107 Stat. 2054.

⁶⁵ P.L. 103-325, 108 Stat. 2255.

for mitigation plans and projects; creation of the National Mitigation Fund; and, provisions of additional coverage for compliance with land-use control measures.

In 2004, FEMA was granted statutory authority to penalize policyholders who refused government assistance to elevate, floodproof, demolish or relocate a structure that has been substantially or repetitively damaged by flooding. Some observers have argued, however, that FEMA was not given sufficient financial resources to successfully administer a flood mitigation program designed to target repetitive flood loss properties.

Current Efforts. FEMA's congressional budget justification for FY2006 proposes that the agency approve grants to states and communities to undertake mitigation action on 750 repetitive loss properties, using Flood Mitigation Assistance (FMA) grants to address the RLP problem. For FY2005, all funding for the FMA was directed towards mitigating RLPs.⁶⁶ Also, since 1990, FEMA has offered incentives under the NFIP's Community Rating System (CRS) to communities to address the issue locally.⁶⁷ Through the CRS, the NFIP provides discounts on flood insurance premiums in communities that voluntarily initiate activities over and above the NFIP minimums that reduce flood losses or that increase the number of flood insurance policies.

Under the CRS, communities receive flood insurance premium discounts based on their implementation of local mitigation activities that reduce flood losses. Communities that exceed the NFIP minimum mitigation standards can apply for a rating from Class 1 (45% premium reduction) to Class 10 (0% premium reduction), which is based on the total number of points the community accumulates for implementing various mitigation activities. The higher the number of points, the greater the premium reduction. Class 1 reflects the highest number of possible points and hence the highest premium discounts. According to FEMA, there are over 1,000 communities receiving flood insurance premium discounts. These communities represent 66% of the NFIP's policy base.⁶⁸ The National Flood Insurance Reform Act of 1994⁶⁹ codified the CRS with the goal to "provide incentive for communities to reduce flood losses, to facilitate accurate insurance rating, and to promote awareness of flood insurance."

FEMA's ongoing efforts also include the implementation of its Repetitive Loss Strategy, whose objective is program cost reduction. Towards that goal, FEMA has pursued the following strategy components:

⁶⁶ U.S. Department of Homeland Security, *Performance Budget Overview, Fiscal Year 2005 Congressional Budget Justification*, Jan. 2004, p. FEMA-81.

⁶⁷ Ibid.

⁶⁸ For more information on the NFIP's Community Rating System, see *Flood Insurance: Community Rating System*, available at [<http://www.fema.gov/nfip/crs.shtm>], visited on April 11, 2005.

⁶⁹ P.L. 103-325; 108 Stat. 2255.

Target a Subset of Properties. FEMA's repetitive loss strategy is to identify the highest priority properties — those with four or more loss claims — that would benefit from mitigation activities. As of December 31, 2004, FEMA had identified 11,706 properties that were insured and which had four or more losses or had two or three losses that cumulatively exceeded the apparent value of the building as reported in the insurance policy. The aim of the NFIP is to target these properties for mitigative action that will remove them altogether from the floodplains, elevate, or floodproof them to reduce their exposure to flood risk.

Establish a Special Direct Facility (SDF). FEMA has set up a special direct facility to service these 11,706 SRLPs and provide information about these properties to state and local floodplain management officials. FEMA opened the target group special facility program in order to allow the NFIP to provide consistent control of claims, facilitate data collection, and more easily track mitigation offers of assistance.

The monthly transfer of insured SRLPs to the facility started on May 1, 2000. Properties are evaluated for inclusion in the SDF based on a cause-and-effect relationship between construction characteristics and surrounding terrain as well as the flood losses these properties have sustained. Homeowners who reside in properties that become part of the facility typically receive a letter from the NFIP informing them that their properties have been identified as SRLPs and that their policies will be renewed with the SDF program established by FEMA. All standard rates and periodic rate changes will still apply to policies transferred to the SDF.

Expand Flood Mitigation Funding. FEMA's mitigation funds are available to states and communities to target the riskiest RLPs and offer the owners financial assistance to acquire, elevate, flood-proof, demolish, or relocate buildings out of the floodplain. Current programs available for accomplishing this mitigation include an annual \$20 million transfer for the Flood Mitigation Assistance (FMA) program, the post-disaster Hazard Mitigation Grant Program (HMGP) and Pre-Disaster Mitigation Program (PDM), as well as Increased Cost of Compliance (ICC) funds for substantially damaged structures covered by flood insurance.

Improve Identification of Risks. FEMA provided information and data on the location of individual repetitive loss properties to state and community government agencies.

FEMA Mitigation Programs

FEMA provides financial assistance to states and communities for a variety of flood loss mitigation activities. Grant payments made under the Flood Mitigation Assistance (FMA) program, the Pre-Disaster Mitigation (PDM) program, and the Hazard Mitigation Grant Program (HMGP) are used to assist the communities with such mitigation programs as elevating or relocating flood-prone homes, acquiring vulnerable properties, retrofitting structures, drainage improvements, and other effective measures.⁷⁰

FEMA's mitigation programs — with some exceptions⁷¹ — are funded on a 75% federal, 25% non-federal (i.e., state and local governments, private non-profit organizations, etc.) cost share basis. In addition, by statute, mitigation projects must be cost-effective and technically feasible. This means that the cost of funding of the project must be less than the cost of damages expected to be incurred in future disasters without the project, and that the project will substantially reduce the risk of future damage, hardship, loss or suffering resulting from a major disaster.

Basic Flood Mitigation Assistance (FMA) Program

The Basic FMA program is authorized by 42 U.S.C. §§ 410c-4104d, and was created as part of the National Flood Insurance Reform Act of 1994⁷² to assist states and communities in implementing measures to reduce or eliminate the long-term risk of flood damage to buildings, manufactured homes, and other structures insurable under the NFIP. Eligible projects include elevating, relocating, floodproofing, or demolishing insured structures and acquiring property, and other effective measures. Basic FMA has been funded at \$20 million annually by transfer from the NFIF. The Flood Insurance Reform Act of 2004 (FIRA)⁷³ increased that annual funding level to \$40 million.

Three types of Basic FMA grants are available: planning, project, and technical assistance grants. FMA Planning and project grants are available only to NFIP-participating community. FMA planning grants are used by states and communities to prepare flood mitigation plans. After a community develops an approved flood mitigation plan, it can then apply for a FMA project grant, which funds measures to reduce flood losses. Finally, FMA technical grants are available to states to fund the cost of administering their flood mitigation programs.

⁷⁰ For more information on FEMA's hazard mitigation programs, see *FEMA's Mitigation Grant Programs*, available at [<http://www.fema.gov/fima/mitgrant.shtm>], visited on April, 20, 2005

⁷¹ For example, the Pre-Disaster Mitigation program projects allow small impoverished communities to receive funding on a 90% federal, 10% non-federal cost share basis. The Reform Act of 2004 provides opportunity for 90-10 funding under both FMA and the Pilot Program if the state has added emphasis and provisions in its state mitigation plan.

⁷² S.Rept. 103-414, 103rd Cong. 2nd sess. (1994).

⁷³ P.L. 108-264; 118 Stat. 712.

Since 1999, FEMA has encouraged the states to use FMA project funds to purchase severe repetitive loss properties — those with four or more losses, and structures with two or more losses where cumulative payments have exceeded the property value.

Pre-Disaster Mitigation (PDM) Program

The pre-Disaster Mitigation (PDM) program is authorized by Section 203 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act,⁷⁴ as added by Section 102 of the Disaster Mitigation Act of 2000,⁷⁵ to provide “technical and financial assistance to state and local governments to assist in the implementation of pre-disaster hazard mitigation measures that are cost effective and are designed to reduce injuries, loss of life, and damage and destruction of property....”⁷⁶ The PDM program is due to expire on December 31, 2005.⁷⁷ Eligible projects include acquisition or relocation of vulnerable projects consistent with HMGP, retrofitting for flood hazard, and localized flood control projects. The PDM program applies to all types of natural hazards — hurricanes, earthquakes, tornadoes, etc., — not just floods. The goal of the PDM program is to reduce future losses and cost for the federal taxpayer. The PDM program marked the first time FEMA has implemented a grant program that awards funds for mitigation activities on a nationwide, competitive basis.

Hazard Mitigation Grant Program (HMGP)

The Hazard Mitigation Grant Program (HMGP) was created in November 1988 by Section 404 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act,⁷⁸ to provide funds to each states for implementing long-term hazard mitigation measures following a presidential disaster declaration. HMGP funds are used to implement long-term mitigation solutions to problems, such as elevating and acquiring and relocating structures in flood prone areas. This contrasts with short-term solutions such as buying sandbags and pumps to fight floods. HMGP funds have also specifically been used in recent years to buy out RLPs in the nation’s floodplains.

HMGP grant applicants must work through their state officials because the states are responsible for establishing mitigation priorities and selecting projects for funding based on those priorities. Procedurally, following a presidential disaster declaration, a local government will conduct a community outreach meeting, which is usually attended by federal and state officials. At the meeting property owners have an opportunity to express their interest in receiving mitigation assistance. The local government completes the application and forwards it to the state government.

⁷⁴ P.L. 100-707; 102 Stat. 4689.

⁷⁵ P.L. 106-390; 114 Stat. 1553.

⁷⁶ Ibid.

⁷⁷ P.L. 108-447, 118 Stat. 3343.

⁷⁸ P.L. 100-707; 102 Stat. 4689.

The state submits the application to FEMA and the agency then decides whether or not to provide the hazard mitigation grant. If the grant is issued, the state acts as grantee, receiving funds from FEMA, monitoring the progress of projects, and submitting quarterly reports to FEMA indicating the status and completion date for each approved project.

Increased Cost of Compliance Coverage

The NFIP includes compliance coverage (Increased Cost of Compliance, or ICC) in all new or renewal flood insurance policies on buildings located in mapped special flood hazard areas. This coverage pays policyholders up to \$30,000 to bring substantially damaged buildings into compliance with local ordinances and building codes. The term “substantial damage” means the cost of repairing the damaged building exceeds 50% of its market value (or a lower trigger if adopted locally). The ICC coverage is designed to help offset the additional costs facing a property owner. ICC is funded by a flood insurance surcharge which ranges from \$3 to \$75 per year, contributing nearly \$80 million a year to the insurance fund.

In order to access the ICC funds, the policyholder must file a separate claim which is supported by documentation of the proposed mitigation method (i.e., physically elevating or relocating the building, or demolishing it and reconstructing a fully compliant structure) and evidence that a permit has been or will be issued by the community. Processing ICC claims involves careful coordination between the policyholder, the adjuster and the local permit official. When the community seeks mitigation grant funds from FMA, PDM or HMGP, the ICC claim can be used towards the non-federal share of certain mitigation measures.

IRS and Taxation of Mitigation Grant

On April 15, 2005, President Bush signed into law legislation (H.R. 1134) to amend Section 39 of the Internal Revenue Code (IRC) to exclude disaster mitigation payments paid to property owners from gross income.⁷⁹ These payments are made pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act or the NFIP. FEMA provides flood mitigation grant payments to states, which then pass them on to communities, so property owners can have the necessary resources to reduce damage due to future flooding. The Internal Revenue Service (IRS) had ruled that payments made to property owners to elevate (or otherwise improve through mitigation) their property under FEMA mitigation grant programs were to be included in the property owner’s gross income under Section 61 of the IRC.⁸⁰ In addition, state and local governments were required to file information returns for payments made on behalf of a homeowner under §6041 in the year(s) that the payment(s) is made if the payment(s) is \$600 or more during any calendar year.

⁷⁹ P.L. 109-7; 119 Stat. 21.

⁸⁰ Memorandum from Robert M. Brown, Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service, to Andrew E. Zuckerman, FEMA Director, June 29, 2004.

The concern about making mitigation disaster payments taxable was that the IRS ruling could have resulted in long-term damage to the effectiveness and success of using mitigation as a means of decreasing future cost to the NFIP and the nation as a whole. The public law requires the exclusion of disaster mitigation assistance from gross income and makes it retroactive to assistance received in 2004.

Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004

During debate in the 106th through 108th Congresses on reauthorizing the NFIP, Members also focused attention on establishing a framework for addressing the repetitive loss problem. As indicated earlier, this debate was triggered largely by the 1998 National Wildlife Federation (NWF) publication entitled, “Higher Ground: A Report on Voluntary Buyouts in the Nation’s Floodplains” which revealed that a very small percentage of properties that suffered from repeated flooding were responsible for some 40% of total NFIP loss payments. The study found that flood losses had risen dramatically through the last century, despite huge expenditures on traditional flood control (“structural”) projects. The NWF recommends “non-structural” approaches to reducing flood damages.

In the aftermath of the NWF study, policymakers began to consider utilizing existing FMA programs as the key mechanism to increase funding levels for repetitive loss pre-disaster mitigation, particularly voluntary buyouts, demolition, elevation, and flood-proofing. Most experts believed that using the FMA program framework for repetitive loss mitigation would encourage communities and states to be directly involved with the planning and implementation of their floodplain management strategies. Policymakers also considered requiring homeowners who refused a reasonable mitigation plan offer to pay rates that reflect the actuarial risk associated with their properties. In addition, floodplain managers and disaster policy experts explored ways to get FEMA to work directly with repetitive loss owners on flood hazard mitigation where communities could not afford the minimum 25% cost-share or did not have the capability to manage the mitigation project.

On June 30, 2004, President Bush signed into law the Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004 (FIRA)⁸¹ to reauthorize the NFIP, through September 30, 2008, increase funding for the Basic FMA program (discussed below), create pilot and individual grant programs for reducing severe repetitive loss properties (SRLPs)⁸², and make some programmatic changes to the NFIP to address

⁸¹ P.L. 108-264; 118 Stat. 712.

⁸² Under the Pilot Program a severe repetitive loss property is defined as NFIP-insured single-family property that meets one of two triggers: four or more claims of at least \$5,000 that cumulate to more than \$20,000; or at least two claims with cumulative amount exceeding the value of the property. Non-residential properties are not eligible for mitigation under the Pilot Program. FEMA shall by regulation define SRLP for multi-family properties.

administrative problems that came to light following Hurricane Isabel in September 2003.

Increase Funding for Mitigating Repetitive Loss Properties

FIRA authorizes transfers of funds (total of \$90 million) from the National Flood Insurance Fund into the National Flood Mitigation Fund to aggressively reduce the number of SRLPs. These funds were authorized for three elements of the Flood Mitigation Assistance (FMA) programs: Basic (\$40 million/year),⁸³ Pilot Program (\$40 million/year through FY2009),⁸⁴ and Individual Property (\$10 million/year).⁸⁵ The Basic FMA program funding represents an increase from the current \$20 million a year to \$40 million a year. Most disaster policy experts believe that this \$40 million amount will cover a small percentage of properties that need to be mitigated.⁸⁶ The Individual grant program authorizes FEMA to provide funding for individual repetitive loss properties only if the state or community where the property is located does not have the capacity to manage such activity.⁸⁷

For FY2006, the Administration requested \$28 million for Basic FMA or \$8 million over the funding level of recent years. No funds were requested for the Pilot Program and the Individual Property program. According to Michael Brown, DHS Undersecretary for Emergency Preparedness and Response Directorate, the FY2006 budget request is limited to only the additional \$8 million for the Basic FMA program because the department is studying how to fund the repetitive loss effort from fee income rather than premium income.⁸⁸

Programmatic Changes to Flood Program

FIRA includes several other provisions that make programmatic changes to the NFIP. They include provisions to:

- institute a formula for distribution of Pilot Program FMA funds to states based on the percentage of the total number of SRLPs located within a state;⁸⁹
- amend FEMA's ICC authority to clarify the definition of "repetitive loss structures" and "substantially damaged structures" and that additional insurance coverage is to help cover the cost of

⁸³ P.L. 108-264; 118 Stat. 712, sec. 103(d)(1).

⁸⁴ Ibid., sec. 102(k)(1).

⁸⁵ Ibid., sec. 104(b).

⁸⁶ S.Rept. 108-262, p. 3.

⁸⁷ P.L. 108-264, 118 Stat. 712; sec. 104.

⁸⁸ Executive Office of the President, *Fiscal Year 2006 Budget Proposal for Federal Emergency Management Agency*, February 2005.

⁸⁹ P.L. 108-264, 118 Stat. 712, sec. 102(f)(5)(A).

implementing mitigation measures that are consistent with local ordinances.⁹⁰

- submit a report to Congress on the use of ICC funds and recommendations on ways to overcome any barriers facing flood victims in accessing ICC funds when needed;⁹¹
- authorize actuarial rates on certain coastal and riverine properties leased from the federal government;⁹²
- recommend the creation in statute a state and community's ability to opt in or out of the FMA Pilot Program so no community will be forced to participate regardless of the state's participation;⁹³
- allow ICC to be triggered by the definition of "substantial damage" set forth in a community's ordinance.⁹⁴
- require FEMA to allow local decisions on the types of mitigation offers that will be made to property owners;⁹⁵
- require FEMA to notify property owners about the implications of refusing a mitigation offer under the pilot program;⁹⁶

FIRA requires FEMA to adjust NFIP's insurance rules and rates to require homeowners to pay actuarial rates in the event the policyholder refuses an offer of mitigation under the five-year, FMA Pilot Program.⁹⁷ Specifically, property owners who refuse a reasonable offer of mitigation would have their insurance premiums increased to 150% of the chargeable rate.⁹⁸ In addition, the premium will be increased another 150% following each future claim of more than \$1,500.⁹⁹ At no time, however, can the premium be more than the actuarial rate for the property.¹⁰⁰ Property owners are permitted to appeal insurance premium increases that result from declining an offer based on the following grounds: (1) inability to purchase a functionally equivalent replacement primary residence; (2) damaged property is a

⁹⁰ Ibid., sec. 105.

⁹¹ Ibid., sec. 206.

⁹² P.L. 108-264; 118 Stat. 712, sec. 106(a).

⁹³ Ibid., sec. 102(a).

⁹⁴ Ibid., sec. 105(a).

⁹⁵ Ibid., sec. 102(f)(4).

⁹⁶ Ibid., sec. 102(e)(1)(D).

⁹⁷ Ibid., sec. 102(h).

⁹⁸ Ibid., sec. 102(h)(1)(B).

⁹⁹ Ibid., sec. 102(h)(2).

¹⁰⁰ Ibid., sec. 102(h)(3).

historic property; (3) flooding that prompted designation as a SRLP resulted from significant actions by a third party in violation of federal, state, or local law, ordinance or regulation; (4) in purchasing, the owner relied on a FIRM that indicated the property was not in the mapped flood hazard area; or (5) the owner demonstrates that an alternative eligible activity is at least as cost effective as the initial offer.

Legislative Response to Hurricane Isabel

As a result of concerns raised by flood victims, consumer advocates, and some Members of Congress about the adequacy of payments and the clarity of policies and procedures for filing and adjusting flood insurance claims stemming from Hurricane Isabel in September 2003, Congress included several provisions in FIRA to provide assurances that agents are knowledgeable about flood insurance policies, policyholders are advised and understand the scope and limitations of the NFIP coverage, and an appeals process exists for claimants. The FIRA requires FEMA to: (1) design supplemental information forms to help policyholders better understand the insurance coverage they buy or renew;¹⁰¹ (2) write a policyholder handbook that describes procedures for filing a claim;¹⁰² and (3) establish a formal process by which policyholders may appeal claims decisions.¹⁰³ FEMA officials stated at the 22nd Annual National Flood Conference held in Marco Island, Florida from May 31 to June 3, 2005, that once the forms have been tested with focus groups and feedback incorporated, these materials will be distributed and new processes implemented beginning October 2005.

FEMA was also required under FIRA to establish insurance agent and adjuster education and training requirements. FEMA is working with the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators to ensure that insurance agents have access to the flood insurance that is necessary to meet the different regulatory requirements in their states.

In addition, FIRA directed the Government Accountability Office (GAO) to undertake a study and report to Congress regarding coverage provided under the NFIP's flood insurance policies and payments made to policyholders who filed claims for eligible damage.¹⁰⁴

Finally, some of the ongoing issues and questions that might be examined in the debate over Hurricane Isabel-related flood victims' allegation that they did not receive adequate payments from the NFIP include the adequacy of the scope of meeting the intended goal of Congress that flood victims be restored to their pre-flood conditions; should programmatic changes be made to ensure that flood victims receive adequate payments under their flood insurance policies to allow them to

¹⁰¹ Ibid., sec. 202(a).

¹⁰² P.L. 108-264, 118 Stat. 712, sec. 204(a).

¹⁰³ Ibid., sec. 205.

¹⁰⁴ Ibid., sec. 208(a).

repair or rebuild their homes;¹⁰⁵ whether the limitations on flood insurance coverage work to the detriment of flood victims in their efforts to repair their homes; what are the practices of FEMA and insurance adjusters in estimating losses incurred during a flood; and, how such practices affect the adequacy of payment of flood victims.

Conclusion

Since the NFIP was enacted in 1968, Congress has pursued a policy of encouraging property and business owners to manage their flood hazard risks through insurance and other hazard insurance mitigation mechanisms. Today, approximately 4.5 million households and businesses in special flood hazard areas in all 50 states, the District of Columbia, and territories have access to affordable federal flood insurance protection.

FEMA is charged with reducing the nation's risk and costs from flooding (and other natural hazards). When FEMA first identified the disproportionate amount of repetitive claims paid on a very small percentage of NFIP-insured properties as the most significant cost factor in the program, the agency took steps to pursue a variety of mitigation strategies to reduce future losses from flooding. In addition, Congress revised the program several times, most recently in 2004, to reauthorize the program through September 30, 2008 and provide additional funding and tools to mitigate severe repetitive loss properties. FEMA has acknowledged, and policymakers agree, that it may take several years to fully solve the RLP problem.

On September 18 and 19, 2003, Hurricane Isabel struck several states along the mid-Atlantic coast. In the aftermath of Hurricane Isabel, flood victims received claims settlements below the cost of repairing their homes. According to FEMA this was because the NFIP was never intended to give victims full compensation for their flood-damaged homes or restore policyholders to "pre-flood conditions."¹⁰⁶ This position, however, differs from those held by previous presidential appointees responsible for the NFIP.

Congress has taken steps to address both the RLP and claims adjustment/settlement issues with the enactment of various provisions in the Flood Insurance Reform Act of 2004, but further legislative measures and/or regulatory changes might be considered in the 109th Congress. Some Members of Congress might call for major reforms of the NFIP, arguing that the NFIP is poorly managed and lacks oversight. For example, there are certain limitations in the payments under the SFIP that result in less than full reimbursement for flood losses. Congress could revisit the scope of coverage for flood policy and the financial impact that broader coverage could have on premiums, the overall costs of the NFIP, and financial

¹⁰⁵ S.Rept. 108-262, p. 5.

¹⁰⁶ Testimony of David I. Maurstad, Acting Director and Federal Insurance Administrator, Mitigation Division, Federal Emergency Management Agency, Emergency Preparedness and Response Directorate, Department of Homeland Security, before the House Financial Services Committee, Subcommittee on Housing and Community Opportunity, *Review and Oversight of the National Flood Insurance Program*, hearings, 109th Cong., 1st sess., April 14, 2005 (Washington: GPO, 2005), p.5.

solvency and market penetration. The GAO studies required under the FIRA will provide future guidance and possible recommendations for additional change to the program.

Appendix A. National Flood Insurance Program Operating Results by Fiscal Year: 2000-2004**(Dollars in Thousands)**

	2000	2001	2002	2003	2004
Number of Policies in Force	4,269,694	4,347,855	4,390,083	4,423,505	4,498,324
Amount of Insurance In Force	\$548,091,057	\$587,005,003	\$627,417,898	\$661,691,405	\$722,714,914
INCOME					
Earned Premium Revenue	1,374,740	1,501,159	1,456,518	1,652,745	1,772,776
Investment Revenue	0	0	0	1,368	5,977
Other Revenue	6,210	5,887	6,533	7,482	6,097
Federal Policy Fee	94,245	96,023	99,780	102,957	107,126
TOTAL INCOME	1,475,195	1,603,069	1,562,831	1,764,552	1,891,976
Transfer to National Flood Mitigation Fund	20,000	20,000	20,000	20,000	20,000
Transfer to Flood Map Modernization Fund	n/a	17,730	5,720	n/a	n/a
EXPENSES					
Commissions and Taxes	14,096	13,526	12,680	13,142	12,563
Operating Expenses	46,629	38,895	39,426	54,976	42,918
Community Rating System	3,417	3,545	3,696	3,460	3,306
WYO Expense Allowance	417,845	421,078	434,832	519,017	521,635
Total Underwriting Expenses	481,987	477,044	490,634	590,595	580,422
Loss and Loss Adjustment Expenses	302,473	1,519,088	191,078	601,416	1,484,868
Interest Expense	26,603	8,199	16,550	151	0
Total Insurance Expenses	811,063	2,004,331	723,982	1,212,162	2,065,290
Flood Studies and Surveys	46,121	47,831	49,090	49,161	48,842
Flood Hazard Reduction	7,204	7,232	7,185	8,261	9,282
Insurance Activities	5,818	6,220	6,376	6,842	7,780
Total Floodplain Management	53,325	55,063	56,275	57,422	58,124
Salaries and Expenses	22,820	24,481	26,157	27,372	29,949
Total Administrative Expenses	76,145	79,544	82,432	84,794	88,073
NET INCOME (LOSS)	\$567,987	(\$518,536)	\$730,697	\$447,596	(\$281,387)

Source: Data provided by Federal Emergency Management Agency's Office of Legislative Affairs.

Appendix B. Nationwide Repetitive Loss Property Counts in the National Flood Insurance Program by State, 1978-2004

(As of September 30, 2004)

State Name	Total Number of Repetitive Loss Properties		Total Number of Repetitive Loss Claims		Total \$ Losses for RLPs	Total \$ Losses for Insured RLPs
	Total	Insured	Total	Insured		
Alabama	2,186	1,036	5,675	2,746	103,651,126	53,189,294
Alaska	19	9	45	22	468,843	250,401
Arizona	218	39	486	84	5,869,172	1,024,476
Arkansas	390	104	1,108	301	14,405,843	5,280,867
California	2,962	1,451	7,708	3,919	144,421,027	79,829,560
Colorado	47	18	113	39	1,464,184	336,926
Connecticut	1,153	574	3,277	1,707	46,722,545	27,100,888
Delaware	312	154	813	417	22,134,473	16,084,566
District of Columbia	10	2	25	8	585,392	262,095
Florida	9,678	5,987	23,921	15,026	455,851,366	292,261,012
Georgia	1,023	435	2,670	1,082	51,855,838	20,695,873
Guam	13	9	27	19	388,236	289,894
Hawaii	151	67	411	195	10,039,492	5,643,028
Idaho	18	5	48	19	608,821	269,659
Illinois	2,810	624	8,430	2,022	83,226,346	25,497,041
Indiana	762	271	2,016	777	22,342,873	9,342,981
Iowa	608	246	1,450	619	23,340,342	10,291,484
Kansas	353	92	945	258	17,999,122	7,419,311
Kentucky	1,318	585	4,037	1,893	66,200,762	35,373,382
Louisiana	21,875	11,082	66,039	35,237	859,731,825	512,662,404
Maine	161	68	417	186	8,178,156	4,082,065
Maryland	712	395	1,668	932	41,007,154	27,583,335
Massachusetts	2,396	1,545	6,575	4,398	101,567,233	64,450,369
Michigan	553	140	1,385	357	13,415,831	5,586,903
Minnesota	517	151	1,234	376	16,859,610	5,701,448
Mississippi	3,864	1,227	11,428	3,785	149,283,246	62,136,644
Missouri	4,851	886	15,454	3,159	229,297,164	66,068,956
Montana	42	9	92	20	845,214	228,189

State Name	Total Number of Repetitive Loss Properties		Total Number of Repetitive Loss Claims		Total \$ Losses for RLPs	Total \$ Losses for Insured RLPs
	Total	Insured	Total	Insured		
Nebraska	316	51	775	128	8,333,876	1,536,710
Nevada	35	12	85	28	2,465,832	827,427
New Hampshire	107	45	258	119	2,945,926	1,813,318
New Jersey	6,565	3,639	19,626	11,253	281,925,863	166,908,438
New Mexico	25	8	60	20	646,089	205,115
New York	7,141	2,758	18,714	7,475	200,576,210	104,003,561
North Carolina	6,871	4,622	18,024	12,357	334,416,748	216,283,723
North Dakota	211	28	470	62	10,555,394	1,497,568
Ohio	1,203	493	3,216	1,441	43,188,190	24,486,050
Oklahoma	829	225	2,395	717	36,008,920	13,115,020
Oregon	282	160	682	386	14,946,487	9,549,119
Pennsylvania	2,877	1,152	7,702	3,198	145,112,550	71,296,107
Puerto Rico	1,871	327	5,352	958	46,479,279	14,909,992
Rhode Island	169	75	488	235	9,930,123	4,980,642
South Carolina	1,396	650	3,389	1,669	78,687,781	34,262,502
South Dakota	80	23	170	53	2,460,619	989,248
Tennessee	702	318	1,965	876	25,984,223	14,890,963
Texas	17,129	5,894	49,263	17,611	1,155,911,731	509,918,097
Utah	23	3	58	7	1,087,641	150,394
Vermont	51	22	118	56	1,467,482	875,499
Virgin Islands	194	88	508	238	21,882,015	12,701,456
Virginia	2,076	1,248	5,262	3,134	114,998,842	66,915,302
Washington	796	370	2,129	1,000	43,494,636	21,396,822
West Virginia	2,158	1,001	5,463	2,613	85,591,219	44,698,828
Wisconsin	422	219	949	499	13,126,470	6,490,184
Wyoming	9	2	22	4	237,301	33,971
TOTAL	112,540	50,644	314,640	145,740	\$5,174,222,683	\$2,686,779,107

Source: Data provided by Federal Emergency Management Agency's Office of Legislative Affairs.

**Appendix C. Nationwide Total Federal Flood Insurance Claims Ranked By
Insured Repetitive Losses and By State: 1978-2002**

State	Policies	Premium	Payments	Net Payments¹ (\$)	Insured Repetitive Losses²	Insured Losses for Top States
Louisiana	8,909,351	1,944,852,707	1,716,259,192	228,593,515	512,662,404	
Texas	9,303,971	1,998,838,643	2,677,702,917	-678,864,274	509,918,097	
Florida	35,493,732	7,267,542,382	1,564,300,440	5,703,241,942	292,261,012	
North Carolina	1,765,883	457,559,654	659,280,778	-201,721,124	216,283,723	Top 5
New Jersey	4,179,680	1,226,218,767	587,975,969	638,242,798	166,908,438	63%
New York	2,607,995	742,366,529	365,556,100	376,810,429	104,003,561	
California	6,655,640	1,756,762,158	363,930,283	1,392,831,875	79,829,560	
Pennsylvania	2,077,521	477,932,714	340,169,013	137,763,701	71,296,107	
Massachusetts	949,242	32,718,915	217,455,661	109,733,489	67,450,369	Top 10
Virginia	1,531,602	372,251,755	364,129,426	8,122,329	66,915,302	78%
Missouri	589,453	157,355,075	418,861,329	-261,506,254	66,068,956	
Mississippi	1,207,071	240,970,189	275,793,799	-34,823,610	62,136,644	
Alabama	778,760	187,257,548	254,997,487	-67,739,939	53,189,294	
West Virginia	545,336	126,277,645	209,321,008	-83,043,363	44,698,828	Top 15
Kentucky	586,543	131,108,656	178,721,442	-47,612,786	35,373,382	87%
South Carolina	2,367,397	628,098,142	419,158,240	208,939,902	34,262,502	
Maryland	1,051,284	209,037,377	207,890,599	1,146,778	27,583,335	
Connecticut	673,517	242,836,110	98,231,095	144,605,015	27,100,888	
Illinois	1,121,298	283,972,185	209,368,840	74,603,345	25,497,041	Top 20
Ohio	787,564	204,340,986	118,900,116	85,440,870	24,486,050	93%
Washington	613,453	153,244,926	100,714,028	52,530,898	21,396,822	
Georgia	1,141,033	321,376,452	123,823,882	197,552,570	20,695,873	
Delaware	315,708	86,729,575	41,056,875	45,672,700	16,084,566	
Puerto Rico	1,050,256	187,505,926	100,384,348	87,121,578	14,909,992	Top 25
Tennessee	323,857	87,541,026	55,695,254	31,845,772	14,890,963	96%

State	Policies	Premium	Payments	Net Payments ¹ (\$)	Insured Repetitive Losses ²	Insured Losses for Top States
Oklahoma	397,932	\$90,125,058	98,974,449	-8,849,391	13,115,020	
U.S. Virgin Islands	74,597	\$19,590,319	36,700,582	-17,110,263	12,701,456	
Iowa	257,219	\$65,286,028	60,414,867	4,871,161	10,291,484	
Oregon	418,132	\$120,638,379	52,034,870	68,603,509	9,549,119	
Indiana	582,731	\$157,842,408	65,606,120	92,236,288	9,342,981	
Kansas	280,361	\$64,828,018	51,454,791	13,373,227	7,419,311	
Wisconsin	284,887	\$72,363,862	28,630,785	43,733,077	6,490,184	
Minnesota	246,693	\$54,640,273	99,511,587	-44,871,314	5,701,448	
Hawaii	785,192	\$178,112,909	58,039,997	120,072,912	5,643,028	
Michigan	608,935	\$156,775,432	37,463,815	119,311,617	5,586,903	
Arkansas	311,556	\$70,466,272	34,102,958	36,363,314	5,380,867	
Rhode Island	280,843	\$105,327,844	19,373,716	85,954,128	4,980,642	
Maine	190,272	\$53,120,522	26,534,038	26,586,484	4,082,065	
New Hampshire	116,443	\$34,299,548	9,616,591	24,682,957	1,813,318	
Nebraska	327,819	\$71,334,470	20,386,027	50,948,443	1,536,710	
North Dakota	226,515	\$42,151,810	132,130,633	-89,978,823	1,497,568	
Arizona	773,929	\$162,147,589	22,987,493	139,160,096	1,024,476	
South Dakota	64,288	\$16,300,808	13,659,006	2,641,802	989,248	
Vermont	77,212	\$21,410,049	6,495,785	17,914,264	875,499	
Nevada	293,780	\$71,887,752	25,935,984	45,951,768	827,427	
Colorado	366,004	\$99,708,448	7,658,574	92,049,874	336,926	
Guam	3,600	\$1,519,837	1,497,638	22,199	289,894	
Idaho	113,216	\$26,896,321	4,172,694	22,723,627	269,659	
District of Columbia	9,867	\$1,539,969	924,117	615,852	262,095	
Alaska	85,407	\$17,654,708	2,586,086	15,068,622	250,401	
Montana	99,692	\$19,426,154	5,277,094	14,149,060	228,189	
New Mexico	244,464	\$57,693,471	2,206,825	55,486,646	205,115	
Utah	76,613	\$15,733,166	4,792,367	10,940,799	150,394	
Wyoming	51,979	\$12,801,490	1,342,100	11,459,390	33,971	
TOTAL	94,277,325	\$21,700,789,191	\$12,600,189,704	\$9,100,599,487	\$2,686,779,107	Top 54 100%

Source: Data provided by Federal Emergency Management Agency's Office of Legislative Affairs.

¹Net payments total is the difference between what residents in the state paid in premium payments minus payments or losses paid on all federal flood insurance claims.

²Insured repetitive losses total is the total payments on FEMA-designated repetitive loss properties that are insured under the NFIP.

**Appendix D. Number of Repetitive Loss Properties in FEMA's
Target Group Special Direct Facility, By State**

(As of December 31, 2004)

State	Number of Properties	Total Premium (\$)
Alabama	208	303,652
Alaska	2	1,083
Arizona	6	\$3,871
Arkansas	24	23,917
California	298	255,664
Colorado	1	1,047
Connecticut	156	181,811
Delaware	39	86,233
District Columbia	2	7,113
Florida	921	953,389
Georgia	79	55,362
Hawaii	31	43,371
Idaho	1	435
Illinois	179	136,327
Indiana	58	37,635
Iowa	32	29,543
Kansas	22	35,901
Kentucky	204	173,950
Louisiana	3,208	2,311,476
Maine	12	16,573
Maryland	43	56,001
Massachusetts	359	427,018
Michigan	15	14,874
Minnesota	16	14,176
Mississippi	336	182,259
Missouri	400	351,772
Montana	0	0
Nebraska	15	7,793
Nevada	2	910
New Hampshire	4	2,834
New Jersey	1,034	1,039,831
New Mexico	1	193
New York	554	564,101
North Carolina	790	747,259
North Dakota	1	624
Ohio	98	88,021
Oklahoma	69	39,939
Oregon	32	28,987
Pennsylvania	214	207,249
Puerto Rico	58	69,933
Rhode Island	22	60,105
South Carolina	111	113,250
South Dakota	3	3,375
Tennessee	78	61,785
Texas	1,573	1,177,550
Utah	0	0
Vermont	5	6,187
Virgin Islands	15	42,960

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State	Number of Properties	Total Premium (\$)
Virginia	151	157,155
Washington	65	42,772
West Virginia	147	100,031
Wisconsin	12	7,902
Wyoming	0	0
Total	11,706	\$10,275,199

Source: Data provided by Federal Emergency Management Agency's Office of Legislative Affairs.